

**Office of
The City Attorney
City of San Diego**

**MEMORANDUM
MS 59**

(619) 236-6220

DATE: August 12, 2011

TO: Eduardo Luna, City Auditor

FROM: City Attorney

SUBJECT: Review of Opinion Regarding Transfer of Revenue Audit Function

You requested that our Office review the City Attorney Memorandum of Law No. 2010-12 (MOL) dated June 10, 2010, which opined that the City Treasurer Revenue Audit Function cannot legally be transferred to the Independent City Auditor. You have requested further review of the MOL, with the specific inquiry of where the audit authority lies for the revenue recovery, since the function may not be transferred to the Auditor.

I have reviewed the MOL; the Independent Budget Analyst (IBA) Report dated May 7, 2010; the City Auditor memoranda dated June 10, 2010, and May 7, 2010; and the City Treasurer memorandum dated May 10, 2010; along with the pertinent San Diego Charter and Municipal Code sections, and San Diego Administrative Regulations. I conducted a further review of recommendations for, and the role of auditing in public sector governance from the Generally Accepted Government Auditing Standards (GAGAS) and well-known government auditing publications, including the Association of Local Government Auditors and The Institute of Internal Auditors.

After a thorough review of these sources, I have come to the same conclusion. The functions of the Revenue Audit Division of the City Treasurer cannot legally be transferred to the City Auditor's Office.¹ The analysis further supports the current organizational structure wherein the City Treasurer (Treasurer) is responsible for management and collection of City revenue and the Independent City Auditor (Auditor) is responsible for auditing such revenue collections.

¹ For an in-depth analysis on the reasons why City Council may not legally transfer the Revenue Audit Division of the City Treasurer to the City Auditors, please see City Att'y MOL No. 2010-12 (June 10, 2010), entitled "Proposed Transfer of the Functions of the Revenue Audit Division of the Treasurer's Office to the City Auditor's Office."

It is widely-known in the government auditing industry that auditors are required to have organizational independence from the departments they audit. Specifically,

[A]udit organizations must be free from organizational impairments to independence with respect to the entities they audit. Impairments to organizational independence result when the audit function is organizationally located within the reporting line of the areas under audit or when the auditor is assigned or takes on responsibilities that affect operations of the area under audit.

Government Accounting Standards, The United States Government Accountability Office (GAGAS), July 2007, § 3.12. This basic tenet is commonly discussed in heavily relied on government auditing publications.

For example, the Institute of Internal Auditors also emphasizes that the auditor needs to have organizational independence from departments it audits. Specifically, “[a]uditors should have sufficient independence from those they are required to audit so that they can both conduct their work without interference and be seen as able to do so” *Everyday Ethics for Local Officials, The Agency Auditing Function*, Institute for Local Government, December 2009, (quoting *The Institute of Internal Auditors, “The Role of Auditing in Public Section Governance”*). In fact, The Institute of Internal Auditors recommends that: “[t]o preserve their independence, government auditors’ advisory/assistance services should never assume a management role” (“The Role of Auditing in Public Sector Governance,” The Institute of Internal Auditors, Nov. 2006, p.5). Proper governance “requires regular financial and performance reporting *that is validated for accuracy by an independent auditor.*” *Id.* at 7 (emphasis added). Also, the San Diego City Auditor’s (Auditor) May 7, 2010, memorandum recognizes: “Standards specifically state that impairments result when an audit function is organizationally located within the reporting line of the areas under audit or when the auditor is assigned or takes on responsibilities that affect operations of the area under audit.”

Here, the Treasurer’s Office performs a management function in the oversight and collection of revenue for the City. The Treasurer’s Office has the managerial duty, not only to collect revenues on a daily basis, but to establish effective controls and assess risks in its collection efforts. The San Diego Municipal Code (SDMC) requires the Treasurer to collect taxes and also gives the Treasurer audit authority in certain scenarios. For instance, with respect to the Transient Occupancy Tax (TOT), the Municipal Code requires the Treasurer to collect the TOT revenue, to inspect all business records of operators², and “to apply auditing procedures” to determine the amount of such tax for which hotel operators are liable. SDMC § 35.0121. The Municipal Code further provides that “it shall be unlawful to refuse to allow or to permit such audit to be conducted after a lawful demand therefor by the City Treasurer, or the City Auditor *when so requested by the City Treasurer.*” *Id.* (emphasis added). Therefore, the revenue compliance audit performed by the Treasurer’s Office is a management function, required to

² “Operator” means the person who is the proprietor of the Hotel, Recreational Vehicle Park, or Campground assessed the TOT tax. SDMC § 35.0102.

ensure proper collections. The Auditor, on the other hand, is not given such access to independent, revenue-producing entities, unless requested to do so by the Treasurer.

The auditor's role is to provide the oversight, insight and foresight to the managing department. "The Role of Auditing in Public Sector Governance," The Institute of Internal Auditors, Nov. 2006, pp 12-13. The government auditor has the duty to assess and report on the success of these collection efforts conducted by the treasurer. The auditor's job is to provide insight by further assisting management in assessing which programs are working and which programs are not. The auditor should also have the foresight to help departments identify trends and challenges before they become crises. *Id.*

Here, the City Charter only gives the Auditor access to an entity's records for all City contracts with "consultants, vendors, or agencies." San Diego Charter § 39.2. These are entities which voluntarily contract with the City, and generally involve spending City revenue. The Charter, however, does not provide the Auditor with the same access to entities which are required to provide revenue to the City, such as the hotel operators (TOT assessments), franchisees, and lessees.

The City of San Diego currently operates with the same organizational structure recommended by GAGAS and government publications for public sector auditing. The Treasurer has the responsibility to manage the collection of revenue. The Auditor has the authority to audit such collections, just as the Auditor conducts audits on other City departments, to objectively determine whether the departmental reports establish a proper basis for the collection of, accounting for, and depositing of revenues and other resources. *The Agency Auditing Function*, quoting The Association of Local Government Auditors. The Auditor, however, may not perform the management function and may not take on responsibilities that affect the operations of the Treasurer's department. The City's current organizational structure with respect to revenue collection also ensures compliance with the Auditor and Treasurer functions as described in the Municipal Code, and the San Diego Charter at sections 39.1, 39.2, and 45³. Further support for the current structure of the revenue audit function can be found when compared to other jurisdictions. The IBA reported that most cities operate in the same manner as the City of San Diego with respect to revenue compliance audits, or collections, i.e., that a finance or revenue related department performs this function – not the auditor.⁴

To summarize, in addition to the requirements found in state and local laws, Government Auditing Publications recommend that the Auditor should be determining whether programs are effective, not actually managing the collection of revenue.

³ For an in-depth analysis on the functions of the Auditor and Treasurer in accordance with the City Charter, please see the City Attorney MOL No. 2010-12 (June 10, 2010), which remains good law.

⁴ See Independent Budget Analyst Report No. 10-39, dated May 7, 2010, entitled, "Analysis Related to a Proposal to Transfer the City Treasurer's Revenue Audit Program to the Office of the City Auditor."

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Therefore, the City Auditor is permitted to perform such revenue audits to determine whether the revenue has been properly collected, in addition to assessing the efficiency and controls of the Treasurer's department, just like the Auditor does for any other City Department(s).

JAN I. GOLDSMITH, City Attorney

By



Kimberly K. Raelin
Deputy City Attorney

KKK:jb

MS-2011-10

cc: Honorable Mayor
City Councilmembers
Andrea Tevlin, Independent Budget Analyst
Gail Granewich, City Treasurer

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